

Policy measures and bargaining power along the food chain, a review to help assessing the way ahead¹

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Extended abstract

This paper examines the current setting of instruments aimed at rebalancing unequal market power in the food chain. Particular attention is given to horizontal integration possibilities for farmers, and organisations of farmers, as derogations to competition policies contained in the Single Common Market Organisation Regulation (EU) 1308/2013 (CMO Regulation). We focus on how these derogations have been defined across agricultural sectors, including the Guidelines tabled by the European Commission. The ultimate objective is to assess whether the current policy framework would allow a smooth functioning of the food supply chain taking into consideration structural inequalities between actors along the chain, i.e. farmers, industry, and retailers while at the same time helping producers to improve their competitiveness.

A literature review to understand sources of asymmetric price transmission (ATP) along the food chain led us to the conclusion that ATP is a source of welfare losses to the detriment of weaker actors (farmers and consumers).

Research work focused on methods for understanding price transmission and identifying asymmetry sources. Empirical studies have pointed to market structure and the growing concentration of the processing and retail firms as the main reasons for asymmetric price transmission and unequal distribution of welfare along the food chain (Sexton 2000, Vavra and Goodwin 2005). Price transmission analysis identified sources of asymmetries, for example significant fixed costs, adjustment costs, inventory management and perishable products (Meyer and von Cramon-Taubadel 2004, Vavra and Goodwin 2005, Fernandez and Crespo 2010, Acharya et al. 2011, Felis and Garrido 2015). Other studies underlined the role of agriculture policies in mitigating bargaining power imbalances (Russo Goodhue Sexton 2011, Cacchiarelli Sorrentino 2013, Ciliberti Frascarelli 2013).

¹ Please note that this paper reflects the views of the authors and should by no means be associated to those of the European Commission. We are grateful to two anonymous referees that allowed to improve a previous version of this paper.

A branch of evidence based research has focused on understanding how the market functions under imperfect competition. Sexton (2013) and McCorriston (2013) have identified factors that may be impacting markets and price developments, other than increasing concentration in processing and retailing sectors. These factors are to be found between vertical related markets and within stages or with respect to the nature of vertical linkages between stages. They include vertical coordination and control between farming and downstream marketing stages; private labels, quality and differentiation, e.g. geographic location, certified safe and respecting fair-trade practises, consolidations through mergers and acquisitions, unfair practises between firms in different stages leading to unequal rent distribution or practises inflicting consumer harm.

The literature on **interactions of cooperatives and antitrust policy and their role in improving market performance** is extensive. Nash et al. (1996) have examined issues in the Australian context focusing on differences in effectiveness across sectors and regions, Youde and Helmberger (1996) analyse antitrust policies and market power in the US, focusing on marketing associations. They consider cooperative marketing as desirable in atomistic structures where concentration in procurement is needed to reach economies of scale. Both Youde Helmberger (1996) and Bergman (1997) argue that cooperatives with restrictive membership should be treated as any other type of business. Based on results from an empirical model that allows price discrimination to be taken into account the European context, Bergman (1997) sustains that if cooperatives export a small fraction of their production and the degree of vertical integration is low, the presence of cooperatives may increase social efficiency by mitigating the market power of for-profit firms. On the contrary, cooperatives with high market share may discriminate between buyers.

Research devoting more policy modelling that accounts for imperfect markets was scarce at the beginning of this century McCorriston (2002), but a number of applications has been developed since then. The work of Russo, *et al.* (2011) highlights that, in presence of market power, benefits from decoupling agriculture support are smaller than under perfect competition (or even negative). They use an approach which relies on shifts in supply, demand or policy to identify and measure market power. Goodhue and Russo (2011) examine the interactions between agriculture policy and market power in the US flour milling industry. Using a non-parametric approach, they demonstrate that US wheat millers were able to increase their margins when farmers received payments through marketing. In other words, market power might allow redistributing benefits from government intervention. Sexton (2013) develops a theoretical model which takes into account vertical coordination, i.e. contracts between farmers and processors in presence of substantial investment costs and product differentiation. He finds that under these conditions buyers matter about the future and they would pay farmers as much or more than a under a competitive market, but in other settings where vertical coordination is not an issue, the exercise of market power would prevail.

Empirical analysis on the **impact of measures aimed at strengthening the bargaining power of farmers in the EU** has focused so far on the role of producer organisations, cooperatives, association agreements and vertical integration of farmers in facilitating economies of scale, improve farmers profit, favour technology adoption and productivity, etc. Bijman *et al.* (2012) inquired the role of cooperatives in reducing the impacts of imbalances

in the food chain for their farmers. They had no results showing that individual cooperatives, including large transnationals like Friesland Campina and Arla Foods in the dairy sector, have sufficient market power to balance the power of the retail giants (although in regional markets they may hold a strong position). In the European retail supply market cooperatives face strong competition from other (foreign) cooperatives and from investor-owned firms (IOFs). The transparency that cooperatives apply in the pricing of their main raw material (e.g. milk or sugar) is beneficial for the bargaining power of retailers as it provides valuable market information. Their findings show that in markets where POs represent a large share, prices for dairy products are higher although this effect is not necessary attributable to the prices that individual POs pay.

Van Hecke (2014) has examined **efficiencies generated by POs** through an extensive literature review. She reports that larger POs have been found to be more profitable as they can spread their fixed costs over larger sales volumes, and offer better prices as well. Larger POs offer in general also more services to their members than smaller POs, especially when these services are associated with significant investment costs. Evidence in the Italian context, where the use of contracts in the dairy, olive oil and fruit and vegetable sectors have introduced greater transparency in trade relationships between agro-food firms, show positive impacts on the financial management of farmers and food processors (Ciliberti and Cacciarelli 2013). Based on a series of studies that compared prices paid between POs and investors owned firms (IOFs) Van Hecke (2014) confirmed that prices paid by POs are higher than prices paid by IOFs (the so-called "yardstick theory"). As a consequence participation by POs could ensure a higher income to farmers. Conversely, little evidence was found of higher consumer prices associated with the presence of POs.

The literature review on asymmetric price transmission along the food chain highlighted that its relevance is related to the potential welfare losses it may entail, notably to weaker actors. Higher concentration in the processing and retail stages makes farmers and consumers the natural candidates. This conclusion led us to scrutinise the current set of instruments aimed at improving the performance of markets through promoting farmers' integration in various forms..

Divergent results emerged from studies on the relation between size and profitability or efficiency, with evidence of significant economies of scale. Larger PO would be more profitable as they can spread their fixed costs over larger sales volumes. In addition, because of this, they could be able to offer better prices. Larger POs may offer more services to their members, especially when these services are associated with significant investment costs. We also expect to find evidence of a positive relationship between participation in the PO and farm income for instance, thanks to higher prices received by farmers participating in POs.

As a next step **we scrutinise the current set of policy instruments**. Exemptions to EU competition policy in the agricultural sector aiming at strengthening farmers' bargaining power have been in place since the CAP inception. Broadly speaking exceptions can be grouped in general and specific derogations² (see Carrau 2012, Del Cont et al. 2012, Carrau

² Derogations are specified in two Council regulations: Reg. 1234/2007 (Single CMO) and Reg. 1184/2006. The Single CMO Regulation applies to products of Annex I of the TFEU and Regulation EC

2014 for a detailed analysis of derogations). A general derogation (Article 42 Treaty on the Functioning of the EU - TFEU) is applicable within the framework of the CAP and taking into account of Article 39 of the TFEU ("objectives of the CAP").

The strengthening of the standing of farmers in the agricultural value chain is a declared objective of the European legislator for changes of the CAP legislation (together with other voluntary initiatives)³ within the 2013-2020 CAP reform. In line with this objective, the general exemption to agriculture is maintained in the new Market Organisation regulation (CMO Regulation)⁴ and sectorial coverage is widened under specific conditions.

One prominent feature is the extension of the possibility to recognise horizontal, vertical agreements and inter-branch agreements to all agriculture products covered by the CMO, as well as the extension of the possibility of contractual negotiations (joint selling) to olive oil, beef and arable crops. POs, associations of POs and IBOs could receive financial support, under certain conditions, within Rural Development Programmes⁵. In addition, specific exemptions are defined and dealt on a case by case approach.

Sector-specific provisions in the CMO that authorise joint activities are defined on a case by case approach. They include joint selling by producers/POs in certain sectors which go beyond what is permissible under general competition rules for agricultural markets.

Provisions for contractual relations in the olive oil, beef and veal, and arable crops sectors. (Articles 169-171 CMO regulation) are meant to secure possibilities for enhanced cooperation for Producer organisations (POs), in addition to what is already permissible under the existing exemptions from competition rules. In other words, the purpose of these Articles is to strengthen the bargaining power of producers, while at the same time avoiding the creation and exertion of market power. Within this objective, the provisions contain safeguards and quantitative thresholds to ensure a level playing field for all operators

In order to help farmers and national competition authorities interpret and apply these provisions, the European Commission has tabled a document containing Guidelines for implementation (EC, 2015). The Guidelines are also meant to ensure legal consistency across EU Member States, as requested by the Parliament during the legislative process of the 2013 CAP reform. The guidelines specify conditions POs must comply to benefit from the derogations, including the recognition of POs and associations of POs, the pursue of specific objectives, the creation of significant efficiencies, relations between the PO, its members, and the Cap on quantities subject to contractual relations and notifications obligations.

Joint selling by POs in the fruit and vegetables sector. As POs and APOs in the fruit and vegetables sector fulfil a particular role, they are granted Union financial assistance in the framework of operational programmes. With a view towards amplifying their effectiveness, POs in fruit and vegetables are required to sell the entire production of their members (with certain exceptions, e.g. for on-farm sale). Unlike collective negotiation possibilities foreseen

No 1184/2006 to products listed in Annex I TFEU with the exception of those covered by the single CMO Regulation.

³ For example the High Level group on the Functioning of the Food Chain and the Food Chain Initiative.

⁴ Regulation (EU) 1308/2013

⁵ Regulation (EU) 1305/2013

in the milk, arable crops, olive oil and beef sectors – there is no market share cap on a Producer Organisation/APO which intends to engage in joint selling.

*Standard written contracts in the milk sector*⁶: the joint sale of raw milk by POs was introduced by the so-called 'milk package'⁷, where the price payable for the delivery may be set in a so-called model of "written contract"⁸. Unlike the provisions on olive oil, beef and arable crops, the possibility of milk POs to jointly sell (and set prices) for the raw milk of their members is limited only by certain (generous) quantitative thresholds (up to 33% of national production per PO).

Collective negotiations in the sugar sector. The quota system for sugar applies until the end of the 2016/2017 marketing year (Article 124 CMO Regulation). There will no longer be a guaranteed sugar beet price as from that date. The question arises whether growers will be able to continue to collectively negotiate prices with producers after the end of the quota regime, as is the current practice. Unlike in the milk, arable crops, olive oil and beef sectors there is no explicit collective negotiation provision for sugar beet growers in the CMO. However, the rules for the sugar sector do provide for the collective negotiation of inter-professional agreements between associations of beet growers and sugar manufacturers (so-called 'agreements within the trade').

The CMO Regulation relies on Producer Organisations as the main vehicle for producer cooperation (i.e. extension of the possibilities for agreements in all agricultural sectors) but the current legislative setting could lead to the paradoxical consequence of challenging the existence and/or creation of a PO.

Concluding remarks

In relation to policy measures aimed at improving the functioning of the food supply chain, the CMO Regulation relies on Producer Organisations as the main vehicle for producer cooperation. But the current legislative setting could lead to the paradoxical consequence of impeding the functioning, by challenging the existence and/or creation of POs. There is no requirement for a *specific* legal form for the recognition of a Producer Organisation. Cooperatives are among the most common organisational forms of establishment in the agricultural sector, especially in Eastern Member States. However, cooperatives (as legal form of establishment) are not legally referenced. While cooperatives may in practice often fulfil the requirements for recognition as a Producer Organisation, the CMO rules on Producer Organisations apply to cooperatives only where Producer Organisation recognition has been officially granted by the Member State.

In particular, the derogation for the joint sale of produce by cooperatives does not appear clearly in the Single CMO. Since competition forbids the charging of identical prices, joint selling may be seen as equating to charging identical prices. Thus operations by cooperatives could be exempted only under the general competition rules, if the conditions, i.e. creation

⁶ Articles 148 and 149 CMO Regulation

⁷ This package is one of the remedies to tackle the persistent weakness of this market after the abolition of the Quota Regime.

⁸ Regulation (EU) 261/2012

of efficiencies, benefits for consumers, no disproportionate restriction of competition, are fulfilled. The exemptions available under general competition rules offer only limited protection for the joint sale of products at a common price, arguably the main purpose of a great many agricultural cooperatives. The typical commercial practices of cooperatives have not been challenged by national competition authorities as potentially anti-competitive horizontal cooperation among individual producers.

The case of cooperatives provides a hint of the paradoxical situation that could be faced in the future. Uncertainty, divergent interpretations and difficulties for POs in complying with minimum requirements for exemption may represent a deterrent to the existence/recognition of POs, and cooperatives in particular.

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